

This letter discusses nexus issues. See 35 ILCS 105/1 et seq. (This is a GIL).

June 21, 2002

Dear Xxxxx:

This letter is in response to your letter dated April 8, 2002. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found at <http://www.revenue.state.il.us/Laws/regs/part1200/>.

In your letter, you have stated and made inquiry as follows:

We hereby request a ruling on the application of the sales and use tax to the following transactions.

FACTS

Employees of ABC solicit orders for the sale of a business opportunity ('Contract') from entrepreneurs ('Distributors') in many states. Such solicitations are made by ABC employees either at private shows at hotels and/or through phone solicitations. The Contract provides that ABC will use its marketing expertise to assist the Distributor in the development of a unique market in which to locate vending machines and will arrange for the acquisition and delivery of suitable vending machines. Distributors are solely responsible for servicing and maintaining their vending machines and none of the vending proceeds accrue to ABC.

Contract authorizes ABC to assist in locating suitable machines on behalf of the Distributor. In this regard, ABC directs XYZ (an affiliated corporation) to place orders for vending machines on behalf of the Distributor with an unrelated manufacturer with which XYZ has an exclusive agreement. The Manufacturer in turn will invoice the Distributor in care of XYZ and cause delivery of the vending machines via common carrier directly to the Distributor (copy of invoice attached). The shipping terms are F.O.B. shipping point with title to pass directly to the Distributor. All risks of ownership pass immediately upon shipment from the Manufacturer to the Distributor. Neither ABC nor XYZ ever take title to or possession of the vending machines.

Upon execution of the Contract, the Distributor pays 20% of the Contract price to ABC. This amount is retained by ABC as payment for services rendered. The Contract requires the Distributor to forward the balance of the Contract price to an unrelated escrow agent who, upon proper notice, will distribute the funds to the appropriate

payees. Such funds consist of fees payable to XYZ for services rendered and payment to the Manufacturer for the purchase price of the vending machines acquired by the Distributor.

Additionally, ABC employs no individuals in Illinois and the only state in which XYZ maintains a physical presence or business operations is California.

LAW

Illinois Adm. Code 150.801 requires that a 'retailer maintaining a place of business in Illinois' must register, collect and remit Use Tax to the State of Illinois.' 'Retailer maintaining a place of business in Illinois' includes any retailer having an agent or representative operating in Illinois under the authority of the retailer. 'Retailer' is defined as 'every person in the business of selling tangible personal property for use, and not for resale in any form.' (Illinois Admin. Code 150.201) Additionally, Illinois Adm. Code 140.101 'imposes a tax upon persons engaged in the business of making sales of service, based on tangible personal property transferred incident to sales of service.'

It appears ABC and XYZ companies do not sell tangible personal property or provide taxable service, neither company should be required to collect sales/use tax in Illinois. Additionally, the distributor would be ultimately responsible to self-assess use tax payable directly to Illinois in connection with its purchase of the equipment.

ISSUE

Based on the foregoing, we respectfully request your office's written opinion (including discussion of applicable statutes, cases and/ or rulings) as to whether and to what extent ABC, XYZ, and the Distributors will be liable to Illinois for sales and/or use tax with respect to the equipment and/or marketing services.

If you have any questions regarding this matter, please phone me.

Based upon the facts presented in your letter, and the invoice that was enclosed with it, it appears that the manufacturer sells the vending machines directly to the distributor. The manufacturer then delivers the vending machines to the distributor in Illinois.

Whether a retailer is subject to Illinois Retailers' Occupation Tax (sales tax) liability or is required to collect Illinois Use Tax from its Illinois customers depends upon whether that retailer will be subject to Illinois law. The following information outlines the principles of nexus.

An "Illinois Retailer" is one that either accepts purchase orders in the State of Illinois or maintains an inventory in Illinois and fills Illinois orders from that inventory. The Illinois Retailers is then liable for Retailers' Occupation Tax on gross receipts from sales and must collect the corresponding Use Tax incurred by the purchasers.

Another type of retailer is the retailer maintaining a place of business in Illinois. The definition of a "retailer maintaining a place of business in Illinois" is described in 86 Ill. Adm. Code 150.201(i), enclosed. This type of retailer is required to register with the State as an Illinois Use Tax collector. See 86 Ill. Adm. Code 150.801, enclosed. The retailer must collect and remit Use Tax to the State on

behalf of the retailer's Illinois customers even though the retailer does not incur any Retailers' Occupation Tax liability.

The United States Supreme Court in *Quill Corp. v. North Dakota*, 112 S.Ct. 1904 (1992), set forth the guidelines for determining what nexus requirements must be met before a person is properly subject to a state's tax law. The Supreme Court has set out a 2-prong test for nexus. The first prong is whether the Due Process Clause is satisfied. Due process will be satisfied if the person or entity purposely avails itself or himself of the benefits of an economic market in a forum state. *Quill* at 1910.

The second prong of the Supreme Court's nexus test requires that, if due process requirements have been satisfied, the person or entity must have physical presence in the forum state to satisfy the Commerce Clause. A physical presence is not limited to an office or other physical building. Under Illinois law, it also includes the presence of any agent or representative of the seller. The representative need not be a sales representative. Any type of physical presence in the State of Illinois, including the vendor's delivery and installation of his product on a repetitive basis, will trigger Use Tax collection responsibilities. Please refer to *Brown's Furniture, Inc. v. Wagner*, 171 Ill.2d 410 (1996).

The final type of retailer is the out-of-State retailer that does not have sufficient nexus with Illinois to be required to submit to Illinois tax laws. A retailer in this situation does not incur Retailers' Occupation Tax on sales into Illinois and is not required to collect Use Tax on behalf of its Illinois customers. However, the retailer's Illinois customers will still incur Use Tax on the purchase of the out-of-State goods and have a duty to self-assess their Use Tax liability, and the customer must remit the amount directly to the State.

In general, the imposition of the various local sales taxes in Illinois takes effect when "selling" occurs in a jurisdiction imposing a tax. The Department's opinion is that the most important element of selling is the seller's acceptance of the purchase order. Consequently, if a purchase order is accepted in a jurisdiction that imposes a local tax, that tax will be incurred. See 86 Ill. Adm. Code 270.115(b), enclosed. The tax rate is fixed by the location of the seller, not the delivery location. The fact that the item being sold is shipped from out-of-State or from another Illinois location is immaterial for purposes of local taxes if the sale occurs through order acceptance in an Illinois jurisdiction imposing a local tax. For these transactions the local tax will be incurred.

If a purchase order is accepted outside the State, but the property being sold is located in an inventory of the retailer that is located in an Illinois jurisdiction that has imposed a local tax, then the location of the property at the time of sale will determine where the seller is engaged in business for the purpose of determining the imposition of applicable local sales taxes. In situations in which the retailer has nexus, but both the purchase order acceptance and the location of the property being purchased are outside of the State of Illinois, such sales would only be subject to the Illinois Use Tax at the rate of 6.25%.

Generally, when the Department makes determinations regarding nexus through affiliation with another business, the Department considers many factors. These factors include whether the business in question has any physical presence in Illinois. This can include employees, representatives, independent contractors, or agents operating in Illinois under its authority. It can also include maintaining a sales office, retail store, or any other real or personal property in the State. The Department also looks at other factors, including but not limited to, whether the affiliated business that is present in the State serves as a representative or agent for the business in question and whether or not all transactions between the business in question and the affiliated business are conducted on an "arm's length basis."

We do not have enough information to determine whether or not this applies to you, but there is an exemption from sales tax for automatic vending machines in some situations. After December 31, 2001, the exemption applies to machines and parts for machines used in commercial, coin-operated amusement and vending businesses, so long as the owner, operator or user of the machine incurs a use or occupation tax liability. Two examples of situations in which the tax liability is incurred on machines are: a) Retailers' Occupation Tax is incurred on the sale of tangible personal property through the vending machine, or b) Use Tax liability is incurred on tangible personal property that is awarded as a "prize" resulting from the operation of the amusement machine. For more information about this exemption, see the enclosed copy of the Department's regulation on "Automatic Vending Machines," at 86 Ill. Adm. Code 130.332.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Martha P. Mote
Associate Counsel

MPM:msk
Enc.